Supreme Court, U. S.
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77-604
No.

In the Supreme Court of the United States

OCTOBER TERM, 1977

A. J. WHITE & CO.
ALLEN J. WHITE, PETITIONERS

v.

SECURITIES & EXCHANGE COMMISSION, RESPONDENT

PETITION FOR ISSUANCE OF WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

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September 15, 1977

In The Supreme Court of the United States

ALLEN J. WHITE et al :
v. : No.

SECURITIES AND SECURITIES EXCHANGE COMMISSION
RESPONDENT

PETITION FOR ISSUANCE OF WRIT OF CERTIORARI

Now come the Petitioners A. J. WHITE & CO. and ALLEN J. WHITE to pray for the issuance of the extraordinary Writ of Ceritiorari from this Honorable Court to the United States Court of Appeals for the First Circuit, in order to review that opinion of the Court (Appendix A) entered by Decree on June 15, 1977 (Appendix B) in the cause entitled *A. J. White & Co., Allen J. White vs. Securities and Exchange Commission* (no. 77-1420)____ F.2d ____ (1st Cir. 1977). The unreported opinion of the Securities and Exchange Commission is attached hereto as Appendix C. The Initial Decision of the Administrative Law Judge is attached hereto as Appendix D.

The grounds upon which the Petitioners rely in invoking the jurisdiction of this Court are, among others:

(1) the jurisdiction to entertain the within Petition is conferred upon this Court by Sections 2101 and 2106 of Title 28 of the U.S. Code, Rules 10 and 11 of the Federal Rules of Appellate Procedure, and F.R.A.P. 19-25;

(2) the date of the judgment or decree sought to be reviewed is June 15, 1977;

(3) no re-hearing was sought, and there exists no Order of the Court of Appeals or of this Court granting an extension of time within which to petition for certiorari.

The overall question presented for review, apart from weighty, subsidiary questions of law, is the extent to which the Court of Appeals may go to affirm an Order of the Securities and Exchange Commission, and the Initial Decision of its Administrative Law Judge, imposing extreme penalties on regulated persons.

Subsidiary questions:

(1) *Severity of Sanctions and Due Process of Law.*

Both of the Petitioners participated for over ten years in the securities business in proprietary capacities. The penalty imposed by the Administrative Law Judge and affirmed by both the Full Commission and the Court of Appeals barred the Petitioners permanently from associating with any broker-dealer in a proprietary capacity. This despite the fact that the Full Commission found that the allegation of the Enforcement Division of the Commission, which was sustained by the Administrative Law Judge, that the Petitioners had willfully and knowingly failed to make, keep and preserve accounts, correspondence, memoranda, papers, books and other records prescribed by Rule 17a-3 of the Securities and Exchange Commission and Section 17 (a) of the Securities Exchange Act of 1934, was unfounded. See App. A, pp.5-6. Yet the same sanctions were maintained throughout the course of the decision-making process, notwithstanding this significant reversal of the initial finding. It is the position of the Petitioners herein that imposition of the same sanctions by the Court of Appeals and by the Commission is arbitrary and capricious. The sanctions are simply too severe, and their severity and the circumstances under which they have been imposed constitute a denial of due process of law.* The affirmation of the sanctions, while reversing a portion of the finding, amounted to

*The allegedly fraudulent acts took place in January, 1971. The Order of Proceedings was filed in November, 1973. The hearing before the Administrative Law Judge took place in March, 1974; his Initial Decision was filed in January, 1975. The Opinion of the Commission was filed in July, 1976.

an increase by the Commission and by the Court of Appeals of the Administrative Law Judge's penalty Order, while lacking any specific findings to support the increase of sanctions. See *Hanley v. SEC,* 415 F.2d 589 (2d Cir. 1969). Although the Court of Appeals has the discretion to reverse or modify the Sanctions imposed by the Agency upon a regulated person or registrant, without nullifying the administrative agency's finding of violations, the Court in this case said simply "Nor do we find any 'gross abuse of discretion' in the Commission's imposition of sanctions. *Lawrence v. SEC,* 1 Cir., 1968, 389 F.d2 276, 280. The Commission apparently regards conduct of the sort illustrated in this case as a serious breach of the underwriter's duty to investors, see SEC Release 34-11532, July 11, 1975, 2Fed. SEC.L.Rep. (CCH) para. 22,730, and we do not disagree with this judgment." This implied rejection of the argument advanced by the Petitioners in Part A of their brief flies in the face of the decision of the Court of Appeals for the Second Circuit in *Arthur Lipper Corp. v. SEC,*_____ F.2d_____(2d Cir. 1976), and cannot be supported by an administrative order dated July 11, 1975.

(2) *The Court of Appeals Erred When It Affirmed the Commission's Conclusion That There Was Substantial Evidence That the Petitioners Arranged for Extensions of Credit to Purchase Securities.*

It was the finding of the Court of Appeals that the Commission could properly find that the Petitioner Allen White was "fully aware" that the Firm A. J. White & Co., through the underwriting manager, arranged for loans to purchase newly-issued stock. This despite the fact that ". . . there was no direct evidence that White participated in these loans." See App. A, p.4. The Court supported the "not improper" "inference" of the Commission that "White was fully aware of" extensions of credit. As the ambiguous language of the Court of Appeals indicates, the Court is uncertain that the conclusions of the Administrative Law Judge that the Petitioners arranged financing in the form of bank loans for purchase of stock in connection with a best-efforts-all-or-none public offering, and that

such extensions allegedly arranged violated the antifraud, extension of credit, and prospectus delivery provisions of the Securities and Exchange Act of 1933 and 1934 were correct. The Circuit Court labored long and hard (see App. A, pp.1-5) to hold the Petitioner Allen White responsible for the action of the underwriting manager in suggesting that principals of the offering corporation *could* borrow money from Industrial National Bank of Rhode Island and make it available to persons who could use it to purchase stock (App. A, p.3).*

It is the position of the Petitioners that the factual findings for which the Commission and the Court of Appeals found substantial evidence in the record are not violative of that provision of the Securities Law which prohibits directly or indirectly extending or arranging for the extension of credit. The only authority for the Court's conclusion is the decision of the Second Circuit of Appeals in *S.E.C. v. Manor Nursing Centers, Inc.*, 458 F.2d 1082 (2d Cir. 1972). It is not apposite. Moreover, the record does not sustain the resulting finding that by allegedly aiding and abetting in arrangements for the extension of the credit the Petitioners aided and abetted acts, practices and a course of business which allegedly would operate as a fraud or deceit upon investors, thereby placing them in violation of Section 10(b) of the Securities and Exchange Act of 1934 and Rule 10(b)-5 thereunder.

Briefly, the question presented for consideration by this Court is whether or not discussions of the availability of credit from a third party, where no actions are taken by the regulated person to effectuate the extension of credit, are sufficient to be a violation of Section 7(c) (1) of the Securities Exchange Act of 1934.

Additionally, there is the substantial question of law, not reached by the Court of Appeals, as to whether or not the Commission had jurisdiction to proceed on the basis of an alleged violation of Section 7(c) of the 1934 Act, and whether or not the evidence adduced showed a violation of Regulation T of the Board of Governors of

*The full Commission found, however, that the eventual purchases were, at least in the perspective of the recordkeeping statue, bona-fide. App. C, pp.5-6.

the Federal Reserve Board, as alleged by the Division of Enforcement of the Commission, which would thereby give the Commission jurisdiction, or whether in fact it was aviolation of Regulation U of the Federal Reserve Board, which would result in the imposition of liability on the bank—the lender—to Board and private actions, eliminating the Commission's jurisdiction. *Cooper v. Union Bank*, 354 F.Supp. 669 (C.D. Calif. 1973). Significantly, the Court of Appeals ignored the argument of the Petitioners that the Commission had an obligation to allege, and to find through its Administrative Law Judge, that there was proximate cause between the unlawful extension of credit and investor losses. *Junger v. Hertz, Neumark & Warner*, 426 F.2d 805 (2d Cir. 1970). No investor losses were proved.

(3) *The Court of Appeals Neglected to Decide the Issue of Scienter.*

Despite the Commission's finding that the transactions following and resulting from the allegedly illegal extensions of credit were bona fide (App. C, pp.5-6). the Court of Appeals concluded that the Petitioners' failure to disclose the method by which approximately fifty percent of the offering amount was obtained constituted fraud. There was no finding or conclusion, because there was no proof in the record, of any willful or material variance between the terms of the prospectus and the "Method of Distribution." (App. A, pp.6-7). Nor was there any proof or finding that the Petitioners willfully, or even negligently, defrauded investors by inadvertently falsifying the method of distribution.

The Court of Appeals ignored the issue of *scienter* on the part of the Petitioners, and failed to find any intent on their part to injure or defraud investors. Said the Court:

> Whether we view this as a matter of scienter, which petitioners maintain is a substantive element of certain of the offenses charged, or as a matter of willfullness under section 15(b) (4) (D) of the Exchange Act, 15 U.S.C. §780(b) (4) (D), we think the Commission's order justified. *App. A. p.9-10.*

It was the position of the Commission, apparently concurred in by the Court of Appeals, that the regulatory agency does not have to prove that the regulated persons intended to injure or actually injured investors. In argument, it was the position of the Commission that it did not have to prove that investors had suffered injury or loss. Consequently, no investors were produced at the hearing to testify that they had suffered any injury or loss. To the contrary, those investors who did testify testified that they had profited from the transactions in question. It was, further, the position of the Commission that it was an academic point, since the Court of Appeals for the First Circuit had recently found that Section 17(a) of the 1933 Act did not require a showing of *scienter*. *SEC v. World Radio Mission, Inc.*, 554 F.2d 541. (1st Cir. 1976).*

It is, of course, the position of the Petitioners that at least proof of fault in a situation such as this, where the Petitioner Allen White is being held responsible for the acts of his underwriting manager and as an aider and abettor of the broker-dealer. In short, there should at least be negligent conduct proved by the regulatory agency. *SEC v. Lum's, Inc.*, 365 F.Supp. 1046 (S.D.N.Y. 1973).

This Court has indicated that allegations of conduct violative of Section 10(b) of the Exchange Act and Commission Rule 10b-5 thereunder must be supported by proof of *scienter*, that is willful, knowing or purposeful conduct. The Court rejected, in *Ernst & Ernst v. Hochfelder*, 96 S.Ct. 1375 (1976) the position of the Commission that it should not have to show anything more than negligent action or inaction as a precondition to liability. *Ernst & Ernst*, supra, at p. 1388. The Court advanced the long-overdue proposition that section 10(b) of the Exchange Act was intended to proscribe knowing or intentional misconduct, citing *S.E.C. v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 868 (2d Cir. 1968); *Kline v. S.E.C.*, 394 U.S. 976 (1969); *Kohn v. American Metal Climax, Inc.*, 458 F.2d 255 (3rd Cir. 1972). Concluded the Court: ". . . we think the relevant portions of that (Congressional) history support our conclusion that §10(b) was addressed to practices that involve some element of scienter and cannot be read to impose liability for negligent conduct alone." *Ernst & Ernst, supra,* at p. 1385.

All that was found by the Court of Appeals in this case was that the loan transactions, determined to be illegal extensions of credit, materially altered the offering's method of distribution from that specified in the prospectus, and was therefore a violation of section 10(b) and Rule 10b-5 thereunder. Such a finding conflicts with this Court's ruling in *Ernst & Ernst v. Hochfelder,* supra, that the conduct to be proscribed by section 10(b) must be intentional or willful and designed to deceive or to defraud investors by controlling or artificially affecting the *price* of securities.

(4) *The Commission Failed to Establish the Materiality of the Omission For Which It Held the Petitioners Responsible.*

The administrative law judge characterized the financing arrangements that resulted in some of the purchases of the newly-issued stock as "unusual." See App. D, p.24. The Court of Appeals found that it "matters significantly" (App. A, p.6) to investors whether or not some of the minimum amount raised in the best-efforts-all-or-none public offering is raised originally through bank loans, and that the failure of the Petitioners to amend the final prospectus was a fraudulent act giving rise to violations of Sections 5 and 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 of the Rules and Regulations of the Commission.

The Court acknowledged that "petitioners attack(ed) these rulings principally on the ground of materiality." See App. A, p.6.

It is the position of the Petitioners that in addition to the lack of proof of any relationship or casual connection between the extension(s) of credit and investor losses [no losses were alleged], that it was not material to fail to amend the prospectus in the final week of the offering to reveal that purchases of stock by long-standing customers with their consent in nearly all cases and in their names were financed in whole or in part by the proceeds of bank loans. To do so, the Petitioners contend here, is to fly in the face of this

*The question of the Commission's burden of proof, relevant to subsidiary question #2 as well as herein, may be before this Court already. According to recent news reports, the Court of Appeals for the District of Columbia Circuit has ruled that the "preponderance of the evidence" standard is inadequate in cases where sanctions having "extremely serious consequences" are imposed (see question #1 above). *Collins Securities Corp. et al v. S.E.C.* F.2d (D.C. Cir. 1977)

Court's definitions of "material" and "materiality" in *TSC Industries, Inc. et al v. Northway, Inc.*, 96 S.Ct. 2126 (1976), *Affiliated Ute Citizens v. U.S.*, 406 U.S. 128 (1972). Two cases which are inapposite on the facts but pertinent are *U.S. v. Grant*, 462 F.2d 28 (2d Cir. 1972) and *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082 (2d Cir. 1972), which the Court of Appeals wrongly found applicable to this case. Those decisions set forth factual situations which can best be described as classic examples of material misrepresentations and other improprieties designed to create a fraudulent appearance of a public offering. In this case, quite simply put, not only did the Petitioners not mislead the reasonable investor by their failure to amend the final prospectus, there was no finding below that they had misled the reasonable investor by their material omission. Nor was there any finding that there existed a substantial likelihood that they had misled investors by failure to declare that the minimum amount of stock had not been sold in a conventional fashion. *TSC Industries, Inc. et al v. Northway, Inc., supra.* Said the Court: "The knowledge that the minimum amount has been sold to bona fide investors *may* be a very important matter to other investors." (App. A, p.6). This finding is clearly in conflict with this Court's ruling in *TSC Industries, Inc.*, supra, that the moving party must present "a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual signigicance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." At 48 L.Ed.2d 757, 766.

(5) *The Commission and the Court Erred in Taking Official Notice of a Criminal Conviction of Petitioner Allen White, Which Criminal Conviction Was Later Vacated by the U.S. District Court.*

It is clear from the record, particularly the Initial Decision of the administrative law judge (App. D) that the conclusion that revocation of licenses of both Petitioners was in the public interest was found in large part upon the violations of record-keeping statues and rules by both Petitioners, which was in turn largely supported by the plea of guilty of Allen J. White to one count of a criminal indictment in the U.S. District Court for the District of Rhode Island in July of 1973. Subsequent to the hearing of March, 1974 before the administrative law judge, and prior to his decision, this conviction was challenged in the U.S. District Court by Allen White. In January, 1976, this conviction was ruled to have been invalid and was nullified.

Apparently recognizing the precariousness of his position, the administrative law judge, while noting that the conviction itself afforded a basis for the imposition of a sanction (App. D, p. 46), avoided the issue by noting that the Petitioner Allen White's "apparent lack of a basic understanding and appreciation of his responsibilities to the public as well as his customers," and not his criminal conviction, was the basis of a finding that a sanction was essential in the public interest. See App. D, p.49. The full Commission treated the issue of the impact of the Petitioner Allen White's criminal conviction more circumspectly. It did not consider the question at all. Significantly, however, it held that the finding of a violation of the record-keeping statute and regulations of the Commission by the administrative law judge was erroneous. See App. C, pp.5-6.

The Court of Appeals noted in closing that "The administrative law judge, however, explicitly stated that White's criminal conviction was not the basis for imposing sanctions, and made it clear throughout the hearings that he was not interested in the criminal proceedings." See App. A, pp.10-11. This is not so, as previous references to the record will demonstrate. In fact, during the course of the hearings in March of 1974, the administrative law judge cross-examined Allen White over objection, and in response to Mr. White's answers said: "you cannot tell me that all the brokers have pleaded quilty to violations of the Securities Laws, can you?" [Tr. p.1415].

It should also be noted that in its Order of Public Proceedings, the Division of Enforcement of the Commission alleged that Allen

White had entered a plea of guilty to a charge of willfully violating Section 17(a) of the Securities And Exchange Act of 1934 and Commission Rule 17a-3 thereunder, which Order was never amended after the conviction was nullified.

15 U.S.C., §78o(b) accords the Commission the power to "censure or place limitations on the activities of any person associated" with the securities business, or suspend or bar any such person if it can be shown that such person has been convicted of any offense specified in the Securities Laws. Unquestionably, if Allen White had not been "convicted" in July of 1973, the finding of the administrative law judge that severe sanctions were necessary in the public interest might never have been reached. The extent to which the invalid conviction tainted the Initial Decision, and the superficial affirmation of same by the full Commission in July of 1976 presents a novel question to this Court, either by itself or in tandem with the issue advanced in Subsidiary Question #1.

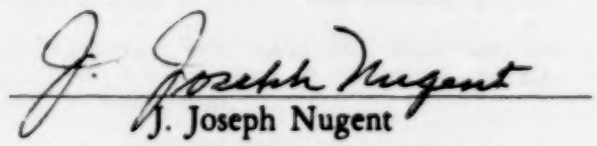
The constitutional provisions, statutes and regulations which this case involves, are reproduced and set forth herein separately as Appendix E attached hereto. The provisions which have been cited are: Section 10b of the Securities Exchange Act of 1934, 15 U.S.C., §78j(b); Rule 10b-5 of the U.S. Securities And Exchange Commission, 17 C.F.R., §240.10b-5; Section 7c of the Securities Exchange Act of 1934, 15 U.S.C., §78g(c); Regulations T and U of the Board of Governors of the Federal Reserve Board, Section 17(A)of the Securities Exchange Act of 1933, 15 U.S.C., §77q(a); Section 5 of the Securities Act of 1933, 15 U.S.C., §77e. See Rule 23 (1) (d) of the Rules of the Supreme Court.

Review of the judgment of a federal court, namely the First circuit Court of Appeals, is sought herein. The basis for federal jurisdiction in that Court was predicated upon a statutory petition for review filed in that Court on or about September 2, 1976 pursuant to §77i of Title 15 of the United States Code. See Rule 23 (1) (g) of the Rules of the Supreme Court.

The issues presented by this case are as follows:

Whether or not the Court of Appeals findings as to *scienter* and materiality are in conflict with decisions of this Court in *Ernst & Ernst v. Hochfelder*, 96 S.Ct. 1375 (1976) and *TSC Industries, Inc. et al v. Northway, Inc.*, 96 S.Ct. 2126 (1976), respectively; whether or not the sanctions imposed at each level were violative of minimum requirements of due process of law accorded to regulated persons (see Subsidiary Question #1); whether the findings of fact below on the issue of illegal extensions of credit arranged by the Petitioners satisfied the Substantial Evidence Rule and §7(c) of the Securities Exchange Act of 1934 (see Subsidiary Question #2); whether or not the Administrative Law Judge relied upon the criminal conviction of Allen White in determining that sanctions should be imposed in the public interest against the Petitioners, and whether or not the nullification of that criminal conviction, which was brought to the attention of both the full Commission and the Court of Appeals, so tainted the other findings of the administrative law judge so as to deprive the Petitioners of due process of law.

Respectfully submitted,



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CERTIFICATE

I hereby certify that a true copy of the printed within Petition for Issuance of Wirt of Ceriorari with Appendices was mailed First Class Mail, postage pre-paid, on October 1977 to the Office of the Solicitor General of the United States, Department of Justice, Washington, D.C.

J. Joseph Nugent

United States Court of Appeals for the First Circuit

No. 76-1420

A. J. WHITE & CO. AND
ALLEN J. WHITE,
PETITIONERS,
v.
SECURITIES AND EXCHANGE COMMISSION,
RESPONDENT.

ON PETITION FOR REVIEW OF AN ORDER OF THE SECURITIES AND EXCHANGE COMMISSION

Before COFFIN, *Chief Judge*,
ALDRICH and CAMPBELL, *Circuit Judges*.

J. Joseph Nugent, Jr., with whom *Nugent & Nugent* was on brief, for petitioners.
David Ferber, Solicitor to the Commission, with whom *Alan Rosenblat*, Assistant General Counsel, and *Linda W. Jarett*, Attorney, Securities and Exchange Commission, were on brief, for respondent.

June 15, 1977

ALDRICH, *Senior Circuit Judge*. This is a petition for review of an SEC order revoking the registration of A. J. White & Co. (White & Co.), a broker-dealer, and barring its president, Allen J. White (White), from association with any broker-dealer. The order provides that after

one year White may apply for leave to become associated with a broker-dealer in a nonproprietary capacity under adequate supervision.[1] Petitioner White & Co. was found to have willfully violated the antifraud, extension of credit, and prospectus delivery provisions of the securities acts, and White to have willfully aided and abetted these violations, in connection with its underwriting of a stock issue of a company called Develco, Inc. According to the prospectus, the underwriting was to be on a "best efforts 65,000 shares or none" basis, that is, although White & Co. was not committed to purchasing any amount of the offering, if it was unable to sell at least 65,000 shares within sixty business days all money received from subscribers was to be refunded and the offering cancelled. Basically, the Commission's contention is that White & Co. realized it would be unable to place the requisite number of shares, but rather than abort the offering, a scheme was devised to make it appear that the offering had been successful.

The facts, as found by the administrative law judge, and affirmed by the Commission, and for which we find substantial evidence in the record, are as follows. Sometime before the deadline for sale of the minimum amount, it became apparent that the offering was not going well. Indeed, the issuer's attorney had threatened White & Co. with suit for failure to use its best efforts. About a week before the deadline, only about one-half of the minimum having been sold, a meeting was held attended by White, Noon, the underwriting manager of White & Co., and the three principals of the issuer. White informed the Develco principals that the offering might have to be aborted. Although at that time approximately $90,000 remained to be raised, the administrative law judge found that White

[1] Sanctions were also imposed on two other individuals associated with White & Co., Noon and McDermott, but neither appealed from the administrative law judge's decision.

told the Develco principals that they were only about $20,000 short. Either White or Noon suggested that the Develco principals could borrow money from the Industrial National Bank of Rhode Island and make it available to persons who could use it to purchase stock. Noon left the meeting to call the bank and returned with the information that two of the Develco principals could each borrow about $9,000, and that they should see a Mr. Glover at the bank. They did so, took out loans, and provided the funds to two Develco employees who purchased stock on the understanding that it would be resold shortly to pay off the loans.

The remaining $70,000 was raised in a similar fashion. Noon and Glover arranged that various friends of Glover, collectively referred to here as the "Warwick Jaycees," take out loans, with the funds to be used for stock purchases. The stock was purchased in the name of six customers of White & Co., two of them supplied by White. Within a short time after the closing, the stock purchased in this manner was resold to pay off the loans. The extent to which the six purported purchasers were informed about the transaction varied. In at least one instance, the customer testified that he knew nothing about the deal until after it was completed. In other cases, including one of White's customers, the individual was asked if he was interested in purchasing Develco stock and his consent was secured only on the understanding that he would not have to provide funds, and on White's assurance that he should not worry because the stock would be resold quickly.

Petitioners' factual contention, essentially, is that White "was not a party, even remotely, to the developments that led to the . . . loans to the Develco principals," and that he did not know that the remaining $70,000 was provided through loans from the Industrial Bank. Although it should

hardly be necessary, we begin by noting that our question is only whether the Commission's findings are supported by substantial evidence, 15 U.S.C. § 78y(a)(4), and thus petitioners' statement that they "cannot agree" with certain of these findings, and their continued objection to the Commission's crediting some witnesses instead of others, based upon petitioners' assessment of the evidence, are entirely beside the point. As to the loans to the Develco principals, petitioners' contention does not meet even their own standard. Whether the loans were initially suggested by White or Noon, it is undisputed that White was present at the meeting, indeed he called it, and he heard and participated in the discussion. Moreover, he admitted that he "was in overall supervisory charge" of White & Co.'s operations, and "participate[d] with [Noon] in each underwriting."[2] As the man in charge, he can hardly wash his hands of the affair merely because he allowed Noon to do the talking.

White's profession of ignorance concerning the other set of loans is more arguable, but we do not find the Commission's conclusions impermissible. While there was no direct evidence that White participated in these loans, it was clear that Noon did so, and the Commission's inference that White was fully aware of this was not improper. Aside from his close supervision of the firm, and Glover's testimony that he never doubted that White was aware of the loans, White's story that he believed that the money had been provided by the Warwick Jaycees as an investment club is not credible. White testified that the stock was placed in other accounts, rather than opening an account for the Warwick Jaycees, because he believed this would

[2] This was not a large firm, having about seventeen employees. Its underwriting operation was on a very small scale. White testified that the firm had engaged in only about six underwritings in its history. There were no other underwritings in progress at the time of the Develco issue.

comport better with the "know your customer" rule, Rule 405 of the New York Stock Exchange. Whatever one may think of his understanding of that rule, his contention does not square with the facts.

To begin with, there is the fact that it was understood that the stock was to be resold quickly, as was done. If the Warwick Jaycees were actually putting up their own money as a bona fide investment, it is hard to see how White could be so confident that they would wish to resell the stock immediately. The most damaging evidence against White's contention is his admission that he received approximately $5,000 from the Warwick Jaycees after the stock was resold in the form of a reduction in the principal of a loan he had outstanding at the Industrial Bank. It is difficult to understand why any ordinary customer would wish to confer a large gift upon his broker, and even more difficult to see why the gift should happen to take the form of paying off a loan at that particular bank. Moreover, several of the nominees retained some portion of the resale profits — another bit of unexplained generosity on the part of the Jaycees. On the other hand, the transactions are quite understandable on the assumption that White knew that the Jaycees were not bona fide customers who would, of course, expect to receive the full amount of the profits on the sale of their stock, but had merely allowed their names to be used on loans, with the profits on resale to be divided among the other participants.[3] Thus we conclude that the Commission's finding that White knowingly participated in the scheme is amply supported.

The Commission found that these transactions "materially altered the method of distribution" of the securities from that specified in the prospectus and that failure

[3] Glover testified that he and Noon had agreed that of the loan proceeds only 90% would be used for the stock purchases, the balance to be divided among the debtor, Glover, and Noon.

to disclose this alteration violated the antifraud provisions, Securities Act § 17(a), 15 U.S.C. § 77q(a); Exchange Act § 10(b), 15 U.S.C. § 78j(b); Rule 10b-5, 17 C.F.R. § 240.10b-5. For the same reasons, petitioners were found to have violated section 5 of the Securities Act, 15 U.S.C. § 77e. *See SEC* v. *Manor Nursing Centers, Inc.*, 2 Cir., 1972, 458 F.2d 1082. Petitioners attack these rulings principally on the ground of materiality.

The inclusion of an "all or none" or "some or none" provision in a best efforts underwriting may serve a number of purposes. Thus a corporation may need a certain minimum amount in order to carry out the enterprise for which funds are being raised. In such a case, if less than the minimum is raised, the corporation might not be able to carry out its plans effectively, and investors could suffer severe losses. Thus it would be a very serious violation of the representations of the issuer and underwriter to the subscribers to declare such an offering sold when the minimum amount had not been realized. See generally Rule 10b-9, 17 C.F.R. § 240.10b-9; *SEC* v. *Manor Nursing Centers*, ante. This is not such a case, however, for here the minimum amount of funds was received by the issuer.

[Our question, therefore, is whether it matters significantly to investors that about one-half of the minimum amount was raised through short-term bank loans rather than bona fide sales to investors. We believe the Commission's conclusion that this, too, was a serious violation was well within its discretion.] The knowledge that the minimum amount has been sold to bona fide investors may be a very important matter to the other investors. Particularly in cases such as this, an offering of shares in a new company, one of the investors' major concerns will be whether the price they are paying for the securities is a fair market price. The inability of the underwriter to

sell the specified minimum to bona fide investors may well indicate that the market judges the offering price to be too high. Thus, to declare an offering completed through non-bona fide sales financed through bank loans, where the purported investors have not made an investment decision backed with their own money, may significantly mislead the legitimate investors as to a crucial factor in their decision.

Nor are the initial investors the only ones likely to be harmed. If the scheme employed by petitioners was to be successful, and the loans repaid, there had to be persons willing to purchase Develco stock after the offering at a price above, or at least equal to, the initial offering price. Such investors, too, would probably be influenced by the representation that the offering had been successful when deciding whether to purchase. Thus, [petitioners' contention that "[n]o manipulation took place," and that no investors lost any money as a result of their actions, may well be shortsighted — many investors may have paid more for these securities than they would otherwise have done, or bought them when they would not otherwise have done so, with, incidentally, White receiving part of the profit.]

In objecting to the Commission's view that disclosure of the change in the method of distribution was required, petitioners point to "the lateness of the hour," apparently suggesting that it was too late to advise subscribers of "these limited 'financing arrangements.'" Even if that is true, petitioners are not aided. If it was too late to disclose the change, the investors had a right to assume that the prospectus would be complied with, not changed.

[Aside from the illegality of the ends, the means by which petitioners made it appear that the offering had been successful constituted clear violations of the securities acts.]

Under section 7(c) of the Exchange Act, 15 U.S.C. § 78g(c), it is illegal for a broker or dealer "directly or indirectly, to . . . arrange for the extension . . . of credit" for the purchase of securities in violation of the regulations of the Federal Reserve System. The Commission found petitioners to have violated this provision since the Federal Reserve regulations allow the extension of credit only on certain securities, and "[t]here is no indication that Develco securities were on the Board of Governors' list of eligible securities, and, given Develco's brief history, it is most unlikely." Petitioners contend that this amounted to an improper shifting of the burden of proof. It seems clear, however, that no substantial right of petitioners was prejudiced. Petitioners do not now contend that the Develco stock actually was an eligible security, a matter easily checked and undoubtedly within petitioners' knowledge. If they suffered, other than technically, they should have filed a motion for rehearing. In any event, even if these securities were eligible, these were 100% loans, far in excess of the Federal Reserve Board's margin requirements. Moreover, these were unsecured loans, and section 7(c)(2) of the Exchange Act, 15 U.S.C. § 78g(c)(2), flatly prohibits a broker or dealer from arranging for loans without collateral for the purchase of securities.

The transactions also violated section 11(d)(1) of the Exchange Act, 15 U.S.C. § 78k(d)(1), which prohibits broker-dealers who have participated in the sale of a new issue from extending or arranging for credit to a customer in connection with a transaction in that security within thirty days of their participation in the sale of the issue. There is no dispute that the Develco offering was a new issue, and we cannot understand petitioners' argument that the thirty day provision was not violated — the credit was arranged for sales which were part of the initial offering.

This is a clear instance of the sort of transaction intended to be barred by section 11(d)(1). As the legislative history makes clear: "This strikes at one of the greatest potential evils inherent in the combination of the broker and dealer function in the same person, by assuring that he will not induce his customers to buy on credit securities which he has undertaken to distribute to the public." H.R. Rep. No. 1383, 73d Cong., 2d Sess. 22 (1934).

The Commission's finding that petitioners' activities amounted to "arranging" for credit is well warranted. As to the loans to the Develco principals, it is undisputed that this was suggested by either White or Noon, not by the customers. With White's knowledge, Noon called the bank, and reported back that the loans could be had. When the borrowers arrived at the bank they found the applications waiting for them. "[N]o detailed analysis is required to determine that an arranging is involved when the broker procures or negotiates financing for the customer by another." *Sutro Bros. & Co.*, 1963, 41 S.E.C. 443, 456. *See also Junger* v. *Hertz, Neumark & Warner*, 2 Cir., 1970, 426 F.2d 805, *cert. denied*, 400 U.S. 880. As to the other set of loans, if the nominees are to be considered the customers, then White is guilty of arranging credit on his own testimony that money supplied by the Jaycees was to be made available to them through the firm. Furthermore, as we have already noted, the Commission could properly find that White was fully aware that the firm, through Noon, was arranging for loans to the Jaycees.

Our discussion thus far implicitly disposes of petitioners' claim that they were not shown to have had the mental state necessary to justify the sanctions imposed. Whether we view this as a matter of scienter, which petitioners maintain is a substantive element of certain of the offenses charged, or as a matter of willfullness under section

15(b)(4)(D) of the Exchange Act, 15 U.S.C. § 78o(b)(4)(D), we think the Commission's order justified. Despite the clear representations in the prospectus, White and Noon chose not to refund the subscribers' funds, but to embark on a series of transactions designed to make it appear that the offering had been successful. They showed no regard whatsoever for the requirements of the credit extension provisions of the Exchange Act. A firm, such as petitioner White & Co., can act only through its agents, and is accountable for the actions of its responsible officers. *Armstrong, Jones & Co.* v. *SEC*, 6 Cir., 1970, 421 F.2d 359, *cert. denied*, 398 U.S. 958. White's knowing participation in the scheme amply supports the Commission's finding that he willfully aided and abetted White & Co.'s violations. Nor do we find any "gross abuse of discretion" in the Commission's imposition of sanctions. *Lawrence* v. *SEC*, 1 Cir., 1968, 398 F.2d 276, 280. The Commission apparently regards conduct of the sort illustrated in this case as a serious breach of the underwriter's duty to investors, *see* SEC Release 34-11532, July 11, 1975, 2 Fed. Sec. L. Rep. (CCH) ¶ 22,730, and we do not disagree with this judgment.

There remain a number of other matters raised by petitioners. We cannot agree with the contention that, as a matter of res judicata, or discretion, the Commission may not institute administrative proceedings after referring the matter for criminal prosecution, as was done in this case. Both the issues and the purposes of the two types of proceedings are different. Indeed, the statutory provision governing administrative proceedings against broker-dealers refutes petitioners' contention, for one of the grounds for sanctions is conviction of a criminal offense involving the sale of securities. 15 U.S.C. § 78o(b)(4)(B). Nor are we persuaded by the argument that it was improper for the Commission to decline to accept petitioners' settlement offers or attempts to voluntarily withdraw their registration. *See Guaranty Underwriters, Inc.* v. *Johnson*, S.D.Fla., 1942, 2 S.E.C. Jud. Dec. 719, *aff'd* 133 F.2d 54; *Fontaine* v. *SEC*, D.P.R., 1966, 259 F.Supp. 880. Litigants are never required to accept settlement offers, and the provision petitioners sought to invoke specifies that broker-dealers may withdraw only "upon such terms and conditions as the Commission deems necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78o(b)(5). Petitioners contend that the Commission's order should be vacated because, after the initial decision of the administrative law judge, White was allowed to withdraw his guilty plea to the criminal charges which had been brought against him. The administrative law judge, however, explicitly stated that White's criminal conviction was not the basis for imposing sanctions, and made it clear throughout the hearings that he was not interested in the criminal proceedings. The Commission's opinion makes no mention at all of White's criminal prosecution. Nor do we find any error in the exclusion of a self-serving affidavit sought to be filed by one of the parties in lieu of his live testimony. Finally, we have examined the record with care and find no warrant for petitioners' claim that the administrative law judge was so biased against them as to amount to a denial of due process.

The order is affirmed.

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UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 76-1420.

A. J. WHITE & CO.,
ALLEN J. WHITE,
Petitioners,

v.

U. S. SECURITIES AND EXCHANGE COMMISSION,
Respondent.

DECREE

Entered June 15, 1977

This cause came on to be heard upon a petition for review of an order of the Securities and Exchange Commission, and was argued by counsel.

Upon consideration whereof, It is now here ordered, adjudged and decreed as follows: The petition for review is denied and the order of the Securities and Exchange Commission is hereby affirmed and enforced.

By the Court:

/s/ Dana H. Gallup
Clerk.

A True Copy

ATTEST:

Dana H. Gallup
Clerk.

[Cert. SEC and Messrs. Nugent and Ferber.]

BEST COPY AVAILABLE

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 12614 / July 9, 1976

Admin. Proc. File No. 3-4390

In the Matter of :
:
A. J. WHITE & CO. :
320 Waterman Avenue :
East Providence, Rhode Island :
:
ALLAN J. WHITE :

OPINION OF THE COMMISSION

BROKER-DEALER PROCEEDINGS

Where registered broker-dealer and its president arranged financings in the form of bank loans for purchase of stock in connection with best efforts all or nothing registered offering in order to close the offering, without disclosing this aspect of the distribution; held, that such arrangements violated the antifraud, extension of credit, and prospectus delivery provisions of the securities statutes. But allegations of improper books and records based on those arrangements, dismissed. Sanctions consisting of revocation of broker-dealer's registration and of an order barring its president from association with any broker or dealer, affirmed.

APPEARANCES:

Willis Riccio and Catherine Keane of the Commission for the Division of Enforcement.

S. Joseph Nugent of Nugent & Nugent for A. J. White & Co. and Allan J. White.

These remedial broker-dealer proceedings under the Securities Exchange Act of 1934 were instituted by order of October 30, 1973. Administrative Law Judge Irving Schiller filed his initial decision on January 21, 1975. Oral argument was waived. The matter was submitted on the briefs.

I. INTRODUCTION

A. J. White & Co., a registered broker-dealer, and Allan J. White, its president, seek review of an administrative law judge's initial decision holding that the firm's broker-dealer registration should be revoked. The decision also held that White should be barred from association with any broker or dealer, provided that after one year he may apply to the Commission to be associated with a broker-dealer in a non-proprietary capacity if adequately supervised.

Our Division of Enforcement opposes the petition for review and moves for summary affirmance of the initial decision. The Division correctly points out that respondents' petition for review was not filed within the time fixed by our Rules of Practice. 1/ However, the sanctions are severe, and respondents' petition was only a few days late. Hence we deem it appropriate to overlook the lateness of the petition and to consider respondents' contentions on their merits.

1/ See Rules 17(b) and 22(j).

II. THE FACTS

The salient facts, which are largely undisputed, are as follows:

1. In 1970, A. J. White & Co. ("registrant") agreed to underwrite a public offering of Develco, Inc. 2/ The terms of the underwriting, as set forth in the prospectus, were described as a "best efforts 65,000 shares or none" underwriting. 3/ By January 1971, registrant and White were concerned that the offering would have to be abandoned, since the minimum amount of securities would not be sold as required by the underwriting terms. 4/

2. White arranged for a meeting to be held either on January 18 or 20, 1971, between himself, Noon, 5/ and three Develco officers to discuss the offering. 6/ White announced early in the meeting that the offering would probably have to be aborted, and there followed a discussion to the effect that money to purchase Develco securities might be obtained through loans at the Industrial National Bank of Rhode Island ("Industrial Bank"), based on the credit standing of Develco's officers. Either Noon or White suggested further that such money could be made available to persons who wanted to purchase Develco securities, but did not have sufficient funds. Noon left the meeting apparently to ascertain the available credit of the Develco officers, and, upon returning to the meeting, announced that arrangements had been made so that two of those Develco officers could obtain up to a total of $18,000 to $20,000 in loans from the bank. Noon also indicated that the officers should see a certain Mr. Glover in making application for the loans at the bank. 7/

2/ Develco, a Nevada corporation, was engaged in the real estate development business, particularly in the low-income housing area. This was the company's first public offering. On May 7, 1970, Develco filed a Form S-1 registration statement with the Commission for 110,000 shares of its $.01 par value common stock at $3.50 per share, and the statement was declared effective on October 28, 1970.

3/ The prospectus explained further "that if 65,000 shares offered hereby are not sold within 60 business days" the offering would be abandoned, and the investors' monies would be refunded.

4/ There was conflicting testimony as to the necessary remaining amount of money to be invested. White testified that $90,000 was required while Develco officers testified that they were informed by White or Noon, an officer of the registrant, that $20,000 was required.

5/ James A. Noon was vice president of registrant and managed the Develco offering for the firm subject to White's supervision. He was a respondent in these proceedings. But he did not appeal from the administrative law judge's decision to bar him from association with any broker or dealer. That decision, which included a proviso enabling Noon to "apply to the Commission to become so associated in a non-proprietary capacity, upon a satisfactory showing to the Commission's staff that he will be adequately supervised," has therefore become effective. James A. Noon, III, Securities Exchange Act Release No. 11262 (February 21, 1975), 6 SEC Docket 308.

6/ These officers were William S. Dogan, president; Robert H. Branchaud, chairman of the board and treasurer; and Robert C. Cournoyer, vice president.

7/ Michael J. Glover was the branch manager of the Industrial Bank's branch in East Providence, Rhode Island.

3. Upon arrival at the bank, Glover directed the officers to complete loan applications which he had prepared and to indicate that the purpose of the loans was personal. After obtaining the loans, the officers contacted two Develco employees and explained that, if they wanted to purchase in the offering, money would be made available to them. Both employees indicated a willingness to purchase in the offering, and both understood and agreed that the securities purchased for their accounts would be sold to meet the loan obligations.

4. An additional $70,000 was invested in Develco just prior to the closing of the offering. This money was obtained through loan arrangements similar to those that have just been described. The record indicates that when registrant realized that the offering was not proceeding as planned, Noon discussed this matter with Glover, and they decided that arrangements could be made whereby funds could be made available for investments in the form of loan proceeds obtained from the bank.

The persons who received loans made these funds available to others who actually purchased Develco securities. The arrangements also provided that the loan commitments would be met by the resale of Develco securities, and the profits would be shared partly by Noon, Glover, and the person who obtained the loan. Glover furnished the names of persons to obtain the bank loans, and most of these persons were members of the Warwick Jaycees. 8/ Noon fulfilled his part of the arrangement and provided the names of the six persons who actually purchased in the offering with the borrowed funds.

5. When the bank approved the loans, the proceeds were disbursed in the form of six cashier's checks which were deposited to the Develco escrow account on January 25, 1971. 9/ Although the checks were drawn to the order of "A. J. White & Co., Develco Escrow Account," one of the six names was typed on the face of each check. Of these six names, three were provided by McDermott, a vice president of registrant and the manager of one of its branch offices, 10/ two by White and one by Noon. In addition, there were three other persons who purchased in the Develco offering through similar loan arrangements.

6. It appears that the purchasers just referred to did not personally place orders to purchase the stock. But order tickets and confirmations were made out. And some of the purchasers knew that their accounts were being utilized for Develco purchases.

For example, one purchaser told White that, even though funds would be available, he could not afford to loss anything if the investment resulted in a loss. White assured that customer that he did not have to worry, and the record indicates that Develco securities were purchased and sold through this customer's account. Another purchaser told Noon

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8/ Glover was president of the organization, and Noon was a member.

9/ Seventy thousand dollars was borrowed in this way. The persons who obtained the loans never actually received the proceeds, nor did the proceeds leave the bank, since the cashier's checks issued by the bank were deposited directly in the Develco escrow account.

10/ The administrative law judge suspended McDermott from association with any broker or dealer for 30 days. No appeal was taken from that decision. And the Commission did not choose to review on its own motion. Richard J. McDermott, Securities Exchange Act Release No. 11222 (February 3, 1975), 6 SEC Docket 213.

that he could not pay for any purchases. But Noon went ahead and placed purchase and sale orders in the account knowing that it had no ability to pay. A third purchaser testified that he indicated to McDermott that he might want to participate in the Develco offering. But this purchaser did not discover that his account had been utilized to make Develco purchases until he received confirmations to that effect. A fourth purchaser testified that McDermott solicited his participation in the Develco offering, and he indicated that he would do so on a delivery against payment basis. When he did not receive the stock, he made inquiry and was informed that shares had, indeed, been placed in his account. 11/

7. McDermott, Noon, White, and the particular person obtaining the loan from the bank shared in the profits that arose in connection with subsequent resale of Develco securities. The record generally indicates that Noon and Glover agreed that 5% of the loan amounts would be divided between themselves and that 5% would be given to the borrower. The record also indicates that part of White's loan at the Industrial Bank was reduced by third party payments, and that he accepted some profits in cash. In addition, there were sufficient profits so that the actual purchasers of Develco securities also received some profit from their resale. But there was no prior agreement to give them such profits. And the timing of the sales was dictated by the fact that the loans at the bank were due.

III. ANTIFRAUD, EXTENSION OF CREDIT, AND PROSPECTUS DELIVERY VIOLATIONS

The terms of the Develco underwriting required that, at a minimum, 65,000 shares had to be sold within 60 business days. Failure to achieve this goal was to result in the abandonment of the offering and in refunds to investors. Because of the conditional nature of the offering, it was especially important that investors be told about the methods to be utilized in marketing or distributing the Develco securities.

When it appeared likely that the Develco offering would have to abort, it is fairly clear that, in order to sell the securities, registrant and White resorted to unusual financing arrangements which involved substantial loans. Money was made available to individuals who did not otherwise have the means to purchase. In some instances the proceeds were placed in particular accounts so that purchases could be made. While these purchases enabled the offering to be closed, the loan arrangements materially altered the method of distribution. These material changes were left undisclosed. The financing arrangements and the events related to them required that the prospectus be amended so as to permit investors to assess the probable effect of those arrangements on the success of the distribution and the closing of the offering. 12/

These arrangements, which in essence constituted 100% financings, relieved the ultimate purchasers from the commitments and the obligations that a purchaser of securities normally incurs. Since the loans were

11/ The circumstances relating to each individual's investment decision and involvement vary in detail. But the general approach and the basic arrangements were uniform in the main.

12/ S.E.C. v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1098-1100 (C.A. 2, 1972).

quite convenient, and were considered windfalls to a number of purchasers, the purchasers did not have to make investment determinations based solely upon the investment risks and merits of the securities. Under the circumstances, the purchasers seemed to have little concern regarding personal obligations under the loans, especially in view of registrant's representations that losses would be most unlikely.

One significant aspect of these arrangements was the fact that the individuals who obtained the loans from the bank agreed to share in the profits of the resale of the securities. These profits provided the incentive whereby such individuals would enter loan obligations with the bank. However, in the context of a traditional securities distribution, this incentive was rather artificial as far as the securities distribution was concerned. Also, the arrangements clearly indicate the extent to which registrant and White would attempt to orchestrate events in order to sell the necessary amount of stock.

It is not that loans are an inappropriate medium for the purchase of securities, or that one cannot protect against investment risks, but that the financing in this case was neatly and conveniently packaged by the registrant, and that the investors did not have to borrow through normal procedures. [These arrangements were an important factor in distributing the securities and closing the offering, and they should have been disclosed to investors.]

Moreover, the financing maneuvers were unlawful. They violated Section 11(d)(1) of the Securities Exchange Act, which makes it unlawful for a broker or dealer distributing a new issue of securities to extend, maintain, or arrange credit for customers in connection with the purchase of such securities. And what was being offered here was a new issue. Accordingly, we find, as did the administrative law judge that registrant's and White's knowledge of, involvement in, and arranging of loans violated Section 11(d)(1).

Similarly, Section 7(c) of the Exchange Act states that it is unlawful for any broker or dealer to extend or maintain credit or arrange for the extension or maintenance of credit on any security, except as provided by regulations of the Board of Governors of the Federal Reserve System. 13/ There is no indication that Develco securities were on the Board of Governors' list of eligible securities, and, given Develco's brief history, it is most unlikely. Thus registrant's conduct was in willful violation of Section 7(c) as well as of Section 11(c)(1).

We also note that, since the prospectus did not accurately disclose the method of distribution, its delivery violated Section 5(b) of the Securities Act because of the document's failure to meet the disclosure standards of Section 10 of the Act. 14/

IV. BOOKS AND RECORDS VIOLATIONS

The administrative law judge found that registrant's books and records did not reflect the economic substance of the transactions. He thought

13/ The Board's regulations provide that a broker-dealer may extend credit only on exchange listed securities and on certain over-the-counter securities that resemble exchange listed securities.

14/ Compare S.E.C. v. Manor Nursing Centers, Inc., supra n. 13.

the books and records deceptive because they indicated that investors had personally placed purchase and sell orders, which was not the case. However, the books and records were accurate as to the actual flow and location of the securities in customers' accounts. 15/

The books and records were current. And it seems fairly clear that the named customers were the actual purchasers. Indeed, the record indicates that some of those customers still had Develco securities in their accounts at the time of the hearings before the administrative law judge. Hence we find no violations in this area.

V. PUBLIC INTEREST

Having found that registrant and White engaged in a fraudulent scheme, we deem it appropriate to affirm the administrative law judge's determination to revoke registrant's registration and to bar White from association with any broker or dealer, with the proviso that he may after one year apply to the Commission for leave to become associated with a broker or dealer in a non-proprietary capacity if adequately supervised.

An appropriate order will issue.

By the Commission (Chairman HILLS and Commissioners LOOMIS and EVANS); Commissioner POLLACK not participating.

George A. Fitzsimmons
Secretary

Shirley E. Hollis

By: Shirley E. Hollis
Assistant Secretary

15/ Generally, the customers involved had pre-existing relationships with registrant, and registrant appeared to exercise discretionary authority over most of these accounts. We do not believe it necessary that customers place orders personally so long as such orders are placed at their direction and are otherwise consistant with their relationship to the broker. In those instances where securities were purchased in accounts without the customers' specific knowledge, we note that the customers did not reject such orders once the transactions came to their attention, and that in most instances they did retain proceeds from the sales either as profits or as funds to meet possible tax liabilities in connection with the transactions.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 12614 / July 9, 1976

Admin. Proc. File No. 3-4390

In the Matter of	:
	:
A. J. WHITE & CO.	:
320 Waterman Avenue	:
East Providence, Rhode Island	:
	:
ALLAN J. WHITE	:

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion of even date herewith, it is

ORDERED that the registration of A. J. White & Co., as a broker and dealer be, and it hereby is, revoked; and it is further

ORDERED that Allan J. White be, and he hereby is, barred from association with any broker or dealer; and it is further

ORDERED that after one year from the date hereof the said Allan J. White be, and he hereby is, permitted to apply to the Commission for leave to become associated with a broker or dealer in a non-proprietary capacity; and it is further

ORDERED that any application of the character referred to in the preceding paragraph be supported by a showing of adequate supervision satisfactory to the Commission's staff.

By the Commission.

George A. Fitzsimmons
Secretary

APPENDIX D
(Excerpts of Initial Decision of Administrative Law Judge)

ADMINISTRATIVE PROCEEDING
FILE NO. 3-4390

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	
A. J. WHITE & CO. ALLAN J. WHITE JAMES A. NOON RICHARD J. McDERMOTT	INITIAL DECISION
(File No. 8-11962)	

APPEARANCES: Willis Riccio and Catherine Keane of the Boston Regional Office of the Commission for the Division of Enforcement

J. Joseph Nugent of Nugent & Nugent for A. J. White & Co., Allan J. White and James A. Noon

Edward C. Jaegerman for Richard J. McDermott

BEFORE: Irving Schiller, Administrative Law Judge

These proceedings were instituted by an order of the Securities and Exchange Commission ("Commission"), dated October 30, 1973 ("Order"), pursuant to Sections 15(b) and 15A of the Securities Exchange Act of 1934 ("Exchange Act") to determine whether, as alleged by the Division of Enforcement ("Division"), A. J. White & Co. ("registrant") wilfully violated and respondents Allan J. White ("White"), James A. Noon ("Noon") and Richard J. McDermott ("McDermott") (sometimes hereinafter referred to collectively as individual respondents) wilfully aided and abetted violations of specified provisions of the Securities Act of 1933 ("Securities Act") and of the Exchange Act and rules thereunder, and whether remedial action is appropriate in the public interest pursuant to the aforementioned provisions of the Exchange Act.

The Order alleges in substance that registrant wilfully violated and the three individual respondents wilfully aided and abetted violations of the following Sections of the Exchange Act and rules thereunder, 17(a) and Rule 17a-3; 10(b) and Rule 10b-5; 7(c)(1) and 11(d)(1) and Sections 17(a) and 5(b) of the Securities Act. The foregoing charges relate to alleged violations committed during the period from about January 20, 1971 to January 26, 1971, during which period registrant acted as underwriter in connection with a public offering of securities by Develco Inc. ("Develco"). The Order also alleges that White and Noon pleaded guilty in the United States District Court for the District of Rhode Island to a charge of violating Section 17(a) of the Exchange Act and Rule 17(a)(3) (17 C.F.R. 240.17a-3). The Order states that each guilty plea was "in connection with the offer and sale

of the common stock of Develco Inc."[1] The Order also notes that in August 1966 the Commission found Noon to have wilfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in the sale of Roto-American Corporation common stock. Noon was suspended from association with any broker-dealer for a period of one year.

At the commencement of the hearing the Order was amended to allege that McDermott was an officer of registrant from September 1970 to May 1971. The amendment further alleges that McDermott consented, without admitting or denying the allegations of a complaint filed by the Commission in the United States District Court, District of Massachusetts, to an injunction against further violations of Sections 5 and 17 of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Securities and Exchange Commission v. Synergistics Inc., et al., Civil Action No. 71-1586-J. (D.C. Mass 1971).[2]

After appropriate notice hearings were held before the undersigned at which all respondents were represented by counsel. However, after four days of hearing Noon failed to attend on the fifth day and thereafter claiming he was "physically and psychologically" unable to continue to be present and he could not "afford any more time taken from work."[3]

1/ Noon was sentenced to one year imprisonment execution of which was suspended and he was placed on probation for one year. White was also sentenced to one year imprisonment and the record discloses that an original two year probation was reduced to one year. Following the closing of the record in these proceedings and the filing of briefs counsel for White advised that he has filed a motion to vacate White's guilty plea.

2/ The final judgment relating to McDermott was dated September 17, 1971.

3/ The record discloses that Noon discharged his attorney at that time. However, several days later Noon submitted a letter requesting leave to (continued)

Noon did not testify orally but sought to establish his defense by means of his own affidavit. Objections by the Division to the receipt in evidence of the affidavit were sustanined and by order dated May 6, 1974 the Commission ruled that the undersigned did not commit reversible error in refusing to receive the said affidavit in evidence. Proposed findings of fact and conclusions of law and briefs were filed by the Division, registrant, White and McDermott. No such findings or brief were filed on behalf of Noon.

The following findings and conclusions are based upon the preponderance of the evidence, as determined from the record, the documents and exhibits therein and upon observation of the witnesses.

The Respondents

Registrant, a Rhode Island corporation, organized in May 1964 has been registered with the Commission pursuant to Section 15(b) of the Exchange Act since 1964. During the period from approximately October 1970 through June 1971 registrant employed seventeen persons at leas ten of whom were registered representatives. It maintained its principal place of business in Providence, Rhode Island and had branch offices in Newton, Massachusetts and Meridan, Connecticut. Registrant was a member of the National Association of Securities Dealers ("NASD")[4], the Boston Stock Exchange, National Stock Exchange and was an associate member of the Baltimore-Washington Stock Exchange. Registrant engaged

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3/ (continued)
permit his counsel to "generally protect his interest in this matter for the remainder of the hearing." Counsel stated on the record he would contine to represent Noon.

4/ The record discloses that in August 1973 registrant tendered its resignation to the NASD.

in retail sales of listed and unlisted securities, acted as principal underwriter and participated in underwritings of securities.

White was president and a director of registrant since its inception. He was primarily responsible for all aspects of registrant's operations and acted as the trader for the firm. All employees were under his supervision. White testified he had an accounting background and was familiar with the various requirements with respect to the proper accounting procedures necessary for maintenance of books and records of broker-dealers.

Noon entered the securities business in 1965. He became associated with registrant in 1969. From some time in 1970 until September 1971 when he left registrant Noon managed two or three underwritings under the general supervision of White. He became vice-president and a shareholder of registrant in February 1971.

McDermott entered the securities business in 1961 and was manager of a brokerage firm until approximately February 1963. From August 1963 to about September 1968 he was employed as a registered representative at four different brokerage firms, was a financial consultant for two years thereafter and became associated with registrant in September 1970. When registrant established a branch office in Newton, Massachusetts, McDermott was manager of the office and in daily communication with and reported directly to White. In February 1971 he was made vice-president and became a shareholder of registrant He left registrant in May 1971.

* * *

Laura and McDermott finally agreed that Laura could keep 40% of the profit for taxes. Laura thereupon signed stock powers which McDermott gave him and gave McDermott two of his personal checks payable to McDermott one for $8,000 the other for $6,750 and retained $4,000 which he stated he used to pay his taxes.

The record discloses that the $8,000 check was cashed at the Industrial Bank. The evidence shows that the $6,750 check was deposited in McDermott's wife's bank account at the Newton Waltham Bank and Trust Company. There is no denial that McDermott received $6,750 from the proceeds of the sale of Laura's stock and the record contains no explanation as to the reason McDermott retained such funds.

Levin, an attorney, who is also in the retail furniture business, was another person whose name McDermott gave White to be used as a purchaser of Develco stock. He testified that McDermott called him in December 1970 and asked him if he was interested in buying Develco a new issue which registrant was bringing out. Levin said he was not interested. In the latter part of January McDermott called him again to ascertain his interest in buying Develco and was told by Levin he was still not interested. McDermott then told Levin that registrant was trying to close out an issue and asked if, he could put some shares in Levin's account "as a favor". Levin said "as a favor" he would "take a few shares". He specifically told McDermott that in accordance with his past custom the shares would have to be delivered against payment. Some time in the middle of February Levin told McDermott he never received any confirmation and asked McDermott if he had been given any shares. McDermott said he had been away and had not received notice of

* * *

Public Interest

The remaining question is what, if any sanction is appropriate in the public interest as to each of the respondents. In this connection it should be noted that White and Noon, in the United States Court for the District of Rhode Island, each pleaded guilty to one count of a 10 count indictment. On July 31, 1973 the said Court, upon White's pleas of guilty to a charge of wilfully violating Section 17(a) of the Exchange Act and Rule 17a-3 thereunder by failing to make, keep and preserve books and other records prescribed under the above mentioned Rule sentenced him to a 1 year suspended sentence, fined him $8,500 and he was placed on probation for 2 years. 25/ On September 23, 1973 Noon pleaded guilty in the same Court to a charge similar to White's and was given a 1 year suspended sentence and probation for 1 year. The indictment related to the offer and sale of the Develco stock. Under Section 15(b) of the Exchange Act such convictions afford a basis for the imposition of a sanction, if found to be in the public interest.

Registrant and White urge that none of the violations alleged were wilfull, that there must be some showing of injury to shareholders and the public interest does not require the imposition of a sanction "for what can be more than extreme technical violations." None of the purported defenses are sufficient to exculpate registrant from the serious and substantive violations found or from the finding that White aided and abetted such violations.

25/ Counsel for White advised by letter dated September 23, 1974 that he filed a motion to vacate his client's pleas of guilty.

With respect to wilfullness the Commission and the Courts have held that a finding of wilfullness is supported by proof that an act was intentionally committed in the sense that a respondent was aware of what he was doing and either consciously, or in a careless disregard of his obligations, knowingly engaged in the activities which are found to be illegal. Nees v. Securities and Exchange Commission, 373 2d 211, 221 (9th Cir. 1969) Tager v. Securities and Exchange Commission 344 F 2d, 5, 8 (2d Cir. 1965). The evidence clearly shows registrant's acts were wilfull and White certainly was aware of what he was doing.

White admitted full responsibility for registrant's operations, knew one week before the Develco offering was to be completed that less than half of the 65,000 shares were sold and that unless some means were devised to complete the offering it would have to be aborted with the resultant loss of underwriting fees. He testified that when he knew arrangements had been made with the Develco principals to borrow $20,000 for the purchase of stock by two employees of Develco, he discussed with Noon and McDermott the matter of obtaining the names of customers of that the $70,000 from the Warwick Jaycees could be used to purchase shares of Develco. The plan for the financing of the purchases by the six nominee accounts, two of which names were furnished by White himself was knowingly carried out by White.

In light of White's testimony that he exercised control over all of registrant's operations it is difficult to believe his argument that he had no knowledge of Noon's arrangements with Glover for the furnishing of funds to be used by the nominees. It is more reasonable

to believe that White many not have known the names of the borrowers but he must have been assured that Noon was attending to whatever mechanical details were necessary to make certain the $70,000 was in the Develco escrow account at the appropriate time. Moreover, the documentary evidence relating to the sales on behalf of the six nominees negates his professed lack of knowledge. It is evident that it was a part of the plan that the Develco stock would be sold out of the said nominees' accounts to repay the loans for, within a week following the alleged completion of the offering, White started selling the Develco stock out of the accounts of the six nominees, the first sale being for his own customer Lecht. The proceeds of such sales he knew or must have known were applied to repayment of the loans. The fallacious rationale given by White for the utilization of the nominee account to wit the so-called "know your customer rule" has been commented upon earlier.

Of utmost significance in weighing White's conduct in light of his responsibility as a broker and an underwriter is the fact that White received approximately $6,000 in what he characterized as "windfall profits" given him by the Warwick Jaycees "in appreciation for you [White's] efforts". Though White testified he did not want any part of the $5,000 applied in reduction of his loan he made no effort to return the money. The conclusion is inescapable that for his participation in the cover-up with respect to the purported completion of the Develco offering White receive a pay-off. His conduct demonstrates

lack of appreciation of his responsibilities as both a broker and dealer or that of an underwriter. White urged at the hearing that he had great faith in Develco and claimed that customers suffered no losses. Neither position is acceptable. The Commission has held that faith in the ultimate success of a business enterprise is not the measure of responsibility under the Federal securities laws. D.F. Birnheimer & Co., Inc., 41 S.E.C. 358, 361 (1963). Nor are losses to customers any such measure. See Bohn-Williams Securities Corp., Securities Exchange Act Release 9327 (September 8, 1971).

The public interest requires the imposition of sanctions for conduct of the nature revealed in these proceeding. The conclusion that a sanction against White is essential in the public interest is reached not upon the basis of White's criminal conviction but his apparent lack of a basic understanding and appreciation of his responsibilites to the public as well as his customers to inform them truthfully of the manner in which the Develco offering was completed. Instead he engaged upon a course of conduct designed to conceal or at the very least comouflage what actually transpired. In light of the serious nature of the various violations found registrant's registration as a broker-dealer should be revoked. Having found that White wilfully aided and abetted registrant's violations the public interest requires that he be barred from association with a broker-dealer with the proviso that after one year from the effective date of this order he may apply to the Commission, to become associated with a registered broker-dealer in a non-proprietary capacity upon a satisfactory showing to the staff of the Commission that he will be adequately supervised.

The public interest also mandates that a sanction be imposed upon Noon for his participation and involvement in the scheme to finance the purchases by the nominees. Glover testified that early in the fall of 1970 he discussed the Develco matter with Noon in terms of having the Industrial Bank act as escrow agent and later held discussion with Noon about arranging for loans to be made at the said Bank, the proceeds of which could be utilized for the purchase of Develco stock. One of the avowed purposes of the arrangement was a 5% profit to be split between Noon and Glover. As a part of the arrangement both Noon and Glover understood the Develco stock would be sold and the loans repaid thus holding the borrowers harmless. Glover also testified that Noon furnished him with a list of the names of persons who were to be used as purchasers of the Develco stock which he had typed on the cashier's checks deposited in the Develco escrow account. Glover further testified that from time to time Noon gave him checks which were cashed and the funds used to repay the loans. Finally Glover testified that the 5% so-called profit was received when "the entire thing was consummated" and that Noon's profit was applied to his loans at the Bank.[26/]

Prior to concluding whether an appropriate sanction is called for in the public interest, consideration was given to ascertaining whether in light of the Commission's order dated May 6, 1974[27/] Noon's affidavit should be received in evidence and, if so, the probative weight to be

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26/ Although Glover was unable to state that the amount he received was exactly 5% he was positive that he received money under the arrangement he had with Noon.

27/ See page 3 supra.

given to it. Notwithstanding that such procedure would deprive the undersigned of the opportunity of observing respondent Noon's demeanor and his responses to cross examination, matters which the Commission's order states are crucial, it has been determined that with recognition of the self-serving nature of an affidavit submitted by a respondent, it could none the less possibly shed some light upon Noon's conduct in the scheme devised to complete the Develco offering. Hence, consideration will be given to the affidavit as though it had been received in evidence and analyze it in the light of other oral and documentary evidence.[28/]

Noon asserts in his affidavit that he was approached by Glover with the proposal that he accumulate monies from members of the Warwick Jaycees for the purpose of investing, at Noon's discretion, in promising securities. Glover on the other hand testified he did not broach the subject of financing the Develco purchases but that he had a discussion with Noon to the effect

> "That perhaps we could arrange some funds for the purchase of the stock through loans from my bank."

Glover further testified that in discussing the loans with Noon the latter was aware that the borrowers would not receive the proceeds but such proceeds would be deposited in the Develco escrow account at the bank to be used to pay for Develco stock purchased by persons other than the borrower. Glover's version of the discussion is credited.

28/ It is emphasized that the procedure adopted in the instant proceeding is not to be deemed a precedent for future proceedings of this nature.

Noon further states that before the offering was to close, Glover advised him he had deposited in the Develco escrow account $70,000 "needed to complete the offering on behalf of the Warwick Jaycees". When White stated the "know your customer" rule "prevented him from doing so" it was transferred to the accounts of seven of registrant's customers with their consent. He admits supervising the bookeeper in breaking down and applying the $70,000. He also admits that sales were made out of the nominee accounts at a profit and that in the case of his customers "most of the profits were returned to Mr. Glover for the benefit of the Warwick Jaycees."

None of the statements by Noon are sufficient to exculpate him from a finding that he wilfully aided and abetted registrant's violations. In fact, his own statements reinforce the findings. Noon admits that the Jaycees wanted to invest their funds in securities at Noon's discretion. Rather than invest their money directly in securities he participated in a plan which permitted other persons or nominees to appear as purchasers under a plan which he knew or must have known would involve the sale of the Develco stock at a profit in which he and the Jaycees would share. Stated differently he participated in the cover up as to who actually supplied the money used to pay for the nominees stock. His statement that the $70,000 was "transferred" to the accounts of seven customers (the record discloses only six were involved) "with their consent" is not credited. None of the nominees who testified stated they consented to the transfer of the Jaycees money to their accounts.

There is nothing in the record to indicate any of the nominees knew the source of the funds used to pay for the stock in their names. Noon admits he handled the proceeds of sales of all the nominees and returned the money to Glover.

Most significant is Noon's statement that "most of the profits were returned to Mr. Glover". Since not all of the profits were given to Glover it is logical to conclude the balance remained with Noon. His conduct like White's cannot be condoned. The record amply supports the findings made earlier that Noon aided and abetted registrant's violations. It is concluded that it is in the public interest that a sanction be imposed upon Noon. Such conclusion is premised on his activities and conduct in connection with the Develco offering. Noon played a vital role in the scheme to obtain loans from the Industrial Bank by persons he knew or must have known would not receive the proceeds of such loans and that such proceeds were to be used for payment of Develco stock to be placed in the names of nominees two of which he himself furnished. He also knew or must have known that it was part of the scheme to sell the nominees' stock to repay the loans and certainly knew of his deal with Glover to "split the profits" of 5%. Although the record does not disclose the exact amount of money applied to Noon's loans at the said Bank, it does reflect from Glover's testimony that some money was so applied. The public interest mandates that Noon be barred from association with a broker-dealer with the proviso that after one year from the effective date of this order he may apply to the Commission to become associated with a registered

broker-dealer in a non-proprietary, non-supervisory capacity upon a satisfactory showing to the staff of the Commission that he will be adequately supervised. The conclusion as the appropriate sanction is premised upon Noon's conduct and participation in the cover-up and concealment of the manner in which the Develco offering was completed and not upon his criminal conviction.

McDermott's participation in at least part of the scheme outlined above is clearly established in the record. The undersigned agrees with the Division's concession that "McDermott's early participation is not as clear." The evidence demonstrates McDermott came into the picture only at the time he was asked to furnish names of customers who could be used as purchasers. There is evidence that McDermott was kept informed of the status of the offering and willingly submitted the names of three persons to be used as nominees. However, the record does not establish by a preponderance of the evidence that he knew of the nature of the plan devised for the financing of the purchases through the Industrial Bank or that he had any knowledge of the arrangements for the financing of the Wante and Brissette shares. It is true that in April after the violation had been committed he assisted White in "clearing up" the Levin transaction and it is reasonable to assume he ascertained at that time what arrangements had been made for financing the purchases. The evidence does not establish that McDermott was as intimately involved in the Develco offering as were White and Noon. However, his participation in the plan cannot be disregarded. Stated differently, McDermott's participation appears to have been limited to the furnishing of three nominees

and not with the entire scheme. For his participation and aiding and abetting in registrant's violations as found, it is in the public interest that McDermott be sanctioned. It is determined that McDermott's conduct affords ample basis for the imposition of a sanction and it is not premised upon the injunction noted in footnote 2 supra. In light of all the circumstances relating to McDermott's participation he should be suspended from association with a broker-dealer for a period of thirty business days. Accordingly,

IT IS ORDERED that the registration of A.J. White & Co. with the Commission is hereby revoked; and respondents Allen J. White and James J. Noon are hereby barred from association with a broker-dealer with the proviso that after one year from the effective date of this order they may apply to the Commission to become registered with a registered broker-dealer in a non-proprietary capacity upon a satisfactory showing to the staff of the Commission that they will be adequately supervised and Richard J. McDermott is hereby suspended from association with a registered broker-dealer for a period of thirty business days from the effective date of this order.

This order shall become effective in accordance with and subject to Rule 17(f) of the Commission's Rules of Practice, 17 CFR 201.17(f).

Pursuant to Rule 17(f) this initial decision shall become the final decision of the Commission as to each party who has not within fifteen days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b),

unless the Commission, pursuant to Rule 17(c) determines on its own initiative to review this initial decision as to him. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party.[29/]

Irving Schiller
Administrative Law Judge

Washington, D.C.
January 21, 1975

29/ To the extent that the proposed findings and conclusions submitted by the parties, and the arguments they make, are in accordance with the views stated herein they are accepted and to the extent they are inconsistent therewith they are rejected.

APPENDIX E

SECURITIES EXCHANGE ACT OF 1934

SECTION 17. (a) Every national securities exchange, every member thereof, every broker or dealer who transacts a business in securities through the medium of any such member, every registered securities association, and every broker or dealer registered pursuant to section 15 of this title, shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other records, and make such reports, as the Commission by it rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors. Such accounts, correspondence, memoranda, papers, books, and other records shall be subject at any time or from time to time to such reasonable periodic, special, or other examinations by examiners or other representatives of the Commission as the Commission may deem necessary or appropriate in the public interest or for the protection of investors.

Rule 17a-3. Records To Be Made by Certain Exchange Members, Brokers, and Dealers

(*a*) Every member of a national securities exchange who transacts a business in securities directly with others than members of a national securities exchange, and every broker or dealer who transacts a business in securities through the medium of any such member, and every broker or dealer registered pursuant to section 15 of the Securities Exchange Act of 1934, as amended, shall make and keep current the following books and records relating to his business:

(1) Blotters (or other records of original entry) containing an itemized daily record of all purchases and sales of securities, all receipts and deliveries of securities (including certificate numbers), all receipts and disbursements of cash and all other debits and credits. Such records shall show the account for which each such transaction was affected, the name and amount of securities, the unit of aggregate purchase or sale price (if any), the trade date, and the name or other designation of the person from whom purchased or received or to whom sold or delivered.

(2) Ledgers (or other records) reflecting all assets and liabilities, income and expenses and capital accounts.

(3) Ledger accounts (or other records) itemizing separately as to each cash and margin account of every customer and of such member, broker or dealer and partiners thereof, all purchases, sales, receipts, and deliveries of securities and commodities for such accounts and all other debits and credits to such account.

(4) Ledgers (or other records) reflecting the following:

(A) Securities in transfer;

(B) Dividends and interest received;

(C) Securities borrowed and securities loaned;

(D) Monies borrowed and monies loaned (together with a record of the collateral therefor and any substitutions in such collateral);

(E) Securities failed to receive and failed to deliver.

(5) A securities record or ledger reflecting separately for each security as of the clearance dates all "long" or "short" positions (including securities in safekeeping) carried by such member, broker, or dealer for his account or for the account of his customers or partners and showing the location of all securities long and the offsetting position to all securities short and in all cases the name or designation of the account in which each position is carried.

(6) A memorandum of each brokerage order, and of any other instruction, given or received for the purchase or sale of securities, whether executed or unexecuted. Such memorandum shall show the terms and conditions of the order or instructions and of any modification or cancellation thereof, the account for which entered, the time of entry, the price at which executed and, to the extent feasible, the time of execution or cancellation. Orders entered pursuant to the exercise of discretionary power by such member, broker, or dealer, or any employee thereof, shall be so designated. The term "instruction" shall be deemed to include instructions between partners and employees of a member, broker, or dealer. The term "time of entry" shall be deemed to mean the time when such member, broker, or dealer transmits the order or instruction for execution or, if it is not so transmitted, the time when it is received.

(7) A memorandum of each purchase and sale of securities for the account of such member, broker, or dealer showing the price, and the extent feasible, the time of execution; and, in addition, where such purchase or sale is with a customer other than a broker or dealer, a memorandum of each order received, showing the time of receipt, the terms and conditions of the order, and the account in which it was entered.

(8) Copies of confirmations of all purchases and sales of securities and copies of notices of all other debits and credits for securities, cash, and other items for the account of customers and partners of such member, broker, or dealer.

(9) A record in respect of each cash and margin account with such member, brokers, or dealer containing the name and address of the beneficial owner of such account and, in the case of a margin account, the signature of such owner: *Provided,* That, in the case of a

joint account or an account of a corporation, such records are required only in respect of the person or persons authorized to transact business for such account.

(10) A record of all puts, calls, spreads, stradles, and other options in which such member, broker, or dealer has direct or indirect interest or which such member, broker, or dealer has granted or guaranteed, containing, at least an identification of the security and the number of units involved.

(11) A record of the proof of money balances of all ledger accounts in the form of trial balances, and a record of the computation of aggregate indebtedness and net capital, as of the trial balance date, pursuant to Rule 15c3-1: *Provided, however,* (i) That such computation need not be made by any member, broker or dealer unconditionally exempt from Rule 15c3-1 by subparagraph (*b*) (1) or (*b*) (3), thereof; and (ii) that any member of an exchange whose members are exempt from Rule 15c3-1 by subparagraph (*b*) (2) thereof shall make a record of the computation of aggregate indebtedness and net capital and of the trial balance date in accordance with the capital rules of at least one of the exchanges therein listed of which he is a member. Such trial balances and computaitons shall be prepared currently at least once a month.

(12) (A) A questionnaire or application for employment executed by each "associated person" (as hereinafter defined) of such member, broker or dealer, which questionnaire or application shall be approved in writing by an authorized representative of such member, broker or dealer and shall contain at least the following information with respect to such person:

15 U.S.C. 78j. Regulation of the Use of Manipulative and Deceptive Devices

SECTION 10. It shall be unlawful for any person. . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rule and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5. Employment of Manipulative and Deceptive Devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ and device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Margin Requirements

SECTION 7. (a) For the purpose of preventing the excessive use of credit for the purchase or carrying of securities, the Board of Governors of the Federal Reserve System shall, prior to the effective date of this section and from time to time thereafter, prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently maintained on any security (other than an exempted security). For the initial extension of credit, such rules and regulations shall be based upon the following standard: ***

(c) It shall be unlawful for any member of a national securities exchange or any broker or dealer, directly or indirectly, to extend or maintain credit or arrange for the extension or maintenance of credit to or for any customer—

(1) on any security (other than an exempted security), in contravention of the rules and regulations which the Board of Governors of the Federal Reserve System shall prescribe under subsections (a) and (b) of this section;

(2) without collateral or on any collateral other than securities, except in accordance with such rules and regulations as the Board of Governors of the Federal Reserve System may prescribe (A) to permit under specific conditions and for a limited period any such member, broker, or dealer to maintain a credit initially extended in conformity with the rules and regulations of the Board of Governors of the Federal Reserve System, and (B) to permit the extension or maintenance of credit in cases where the extension or maintenance of credit is not for the purpose of purchasing or carrying securities or of evading or circumventing the provisions of paragraph (1) of this subsection.

(d) It shall be unlawful for any person not subject to subsection (c) to extend or maintain credit or to arrange for the extension or maintenance of credit for the purpose of purchasing or carrying any security, in contravention of such rules and regulations as the Federal Reserve Board shall prescribe to prevent the excessive use of credit for the purchasing or carrying of or trading in securities in circumvention of the other provisions of this section. Such rules and regulations may impose upon all loans made for the purpose of purchasing or carrying securities limintations similar to those imposed upon members, brokers, or dealers by subsection (c) of this section and the rules and regulations thereunder. This subsection and the rules and regulations thereunder shall not apply (A) to a loan made by a person not in the ordinary course of his business, (B) to a loan on an exempted security, (C) to a loan to a dealer to aid in the financing of the distribution of securities to customers not through the medium of national securities exchange, (D) to a loan by a bank on a security other than an equity security, or (E) ot such other loans as the Board of Governors of the Federal Reserve System shall, by such rules and regulations as it may deem necessary or appropriate in the public interest or for the protection of investors, exempt, either unconditionally or upon specified terms and conditions or for stated periods, from the operation of this subsection and the rules and regulations thereunder.

(4) Any provision of this title (other than section 5 and subsection (a) of this section) which prohibits any act, practice, or course of business if the mails or any means or instrumentality of interstate commerce are used in connection therewith shall also prohibit any such act, practice, or course of business by any broker or dealer registered pursuant to this subsection or any person acting on behalf of such a broker or dealer, irrespective of any use of the mails or any means or instrumentality of interstate commerce in connection therewith.

(5) The Commission shall, after appropriate notice and opportunity for hearing, by order censure, deny registration to, suspend for a period not exceeding twelve months, or revoke the registration of, any broker or dealer if it find that such censure, denial, suspension, or revocation is in the public interest and that such broker or dealer, whether prior or subsequent to becoming so associated-

(B) has been convicted within twn years preceding the filing of the application or at any time thereafter of any felony or misdemeanor which the Commission finds-
(i) involves the purchase or sale of any security.
(ii) arises out of the conduct of the business of a broker, dealer, or investment adviser.
(iii) involves embezzlement, fraudulent conversion, or misappropriation of funds or securities.
(iv) involves the violation of section 1341, 1342, or 1343 of title 18, United States Code.

(D) has willfully violated any provision of the Securities Act of 1933, or of the Investment Advisers Act of 1940, or of the Investment Company Act of 1940, or of this title, or of any rule or regulation under any of such statutes.

15 U.S.C. §77e. Prohibitions Relating to Interstate Commerce and the Mails.

SECTION 5. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

(b) It shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry on transmit any any prospectus relating to any security with respect to which a registration statement has been filed under this title, unless such prospectus meets the requirements of section 10; or

(2) to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 10.

(c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 8.

15 U.S.C. §77q. Fradulent Interstate Transactions

SECTION 17. (a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifices to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice or course of business which operates or would operate as a fraud or deceit upon the purchaser.

(b) It shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or the use of the mails, to publish, give publicity to, circulate any notices, circular, advertisement, news paper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describe such security for consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, with fully disclosing the receipt whether past or prospective, of such consideration and the amount thereof.

(c) The exemptions provided in section 3 shall not apply to the provisions of this section.

U.S. Constitution

AMENDMENT V. (1791)

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.